IN THE COURT OF APPEAL OF NEW ZEALAND

CA313/2011
[2012] NZCA 344

BETWEEN	TELECOM CORPORATION OF NEW ZEALAND LIMITED First Appellant
AND	TELECOM NEW ZEALAND LIMITED Second Appellant
AND	COMMERCE COMMISSION Respondent

Hearing: 21 November 2011

Court: Glazebrook, Chambers and Ellen France JJ

Counsel: D Shavin QC, J E Hodder SC, P Jagose and T Smith for First and Second Appellants
J A Farmer QC, G M Coumbe and J S McHerron for Respondent

Judgment: 3 August 2012 at 12.00 pm

JUDGMENT OF THE COURT

A The appeal is dismissed.

B The appellants must pay the respondent costs for a complex appeal, but limited to a day's hearing and two days' preparation plus usual disbursements. We certify for two counsel.

REASONS OF THE COURT

(Given by Glazebrook J)

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Introduction

[1] In a judgment of 9 October 2009 (the Liability Judgment),[1] Rodney Hansen J and Professor Richardson held that Telecom had breached s 36 of the Commerce Act 1986 (the Act).

[2] In a judgment delivered on 19 April 2011, Rodney Hansen J dealt with the issue of pecuniary relief (the Penalty Judgment).[2] In that judgment, the High Court ordered that Telecom pay a pecuniary penalty of $12 million.

[1] *Commerce Commission v Telecom Corporation of New Zealand Ltd* HC Auckland CIV-2004-404-1333, 9 October 2009 ["Liability Judgment"].

[2] *Commerce Commission v Telecom Corporation of New Zealand Ltd* HC Auckland CIV-2004-404-1333, 19 April 2011 ["Penalty Judgment"].

[3] Telecom appealed against both the Liability and the Penalty Judgment. On 27 June 2012, this Court dismissed Telecom's appeal against the Liability Judgment and allowed the Commerce Commission's cross-appeal.[3] We will refer to the June 2012 judgment as the Substantive Appeal Judgment.

[4] This judgment deals with Telecom's appeal against the Penalty Judgment. Before turning to the issues in this appeal against the Penalty Judgment,[4] we summarise the Liability Judgment,[5] the Substantive Appeal Judgment,[6] the legislative and case law background relevant to penalties[7] and the Penalty Judgment.[8]

The Liability Judgment

[5] In the Liability Judgment, the High Court held that, from 18 March 2001 until late 2004, Telecom breached s 36 of the Act by using and/or taking advantage of its dominant position/market power in the wholesale market for data transmission for the purpose of deterring potential or existing competitors in the wholesale market for backbone transmission services and the retail market for end-to-end high speed data transmission (HSDT) services. The High Court upheld the Commission's claim that some of the wholesale prices charged by Telecom for "data tails" (to achieve network access)[9] were so high, in relation to its retail prices, as to cause a price squeeze.[10]

[6] The High Court held that Telecom's pricing breached the Efficient Component Pricing Rule (ECPR), endorsed by the Privy Council in *Telecom v*

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[3] *Telecom Corporation of New Zealand Ltd v Commerce Commission* [2012] NZCA 278 ["Substantive Appeal Judgment"].

[4] Set out at [20] below.

[5] At [5] below.

[6] At [8] below.

[7] At [10] below.

[8] At [14] below.

[9] "Data tails" are the connection between an end customer's premises and the point where a rival telecommunications service provider (TSP) can take delivery of data signals from Telecom.

[10] A price squeeze occurs when a dominant vertically integrated supplier sets prices in the upstream wholesale market in a manner that prevents equally or more efficient competitors from profitably operating in the downstream retail market.

Clear[11] as the appropriate pricing model where there is a dominant vertically integrated provider of network infrastructure and services. It held that, in the wholesale market for data tails outside major CBD areas, Telecom's pricing breached ECPR in virtually all cases where Telecom provided all the tails in a rival telecommunications service provider (TSP)'s customer network, whether two or more, and the TSP did not self-provide any tails (the "two-tail" scenario). The Court did not consider that Telecom's pricing breached ECPR in cases where a TSP self-provided one or more tails and Telecom supplied the remainder (the "one-tail" scenario).

[7] The Court concluded that the Commission was entitled to both declaratory and pecuniary relief.

The Substantive Appeal Judgment

[8] As noted above, Telecom's appeal against the Liability Judgment was dismissed.

[9] The Commission also challenged the Liability Judgment on the basis that the High Court should have found that Telecom's pricing in the one-tail scenario breached s 36 of the Act and that the Court should have held that declaratory relief was available for the period prior to 18 March 2001. This Court found for the Commission on both those points.

The legislation and case law

[10] Section 80(1) of the Act provides for the imposition of a pecuniary penalty "as the Court determines to be appropriate" for a breach of Part 2 of the Act. Section 36, which prohibits firms with a substantial degree of market power from taking advantage of that power for anti-competitive purposes, falls under Part 2.

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11 *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC) [*Telecom v Clear* (PC)].

[11] The Court's discretion to impose a penalty is subject to the provisions of s 80(2A) and (2B) which provide:

> (2A) In determining an appropriate penalty under this section, the Court must have regard to all relevant matters, in particular,—
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> (a) any exemplary damages awarded under section 82A; and
>
> (b) in the case of a body corporate, the nature and extent of any commercial gain.
>
> (2B) The amount of any pecuniary penalty must not, in respect of each act or omission, exceed,—
>
> (a) in the case of an individual, $500,000; or
>
> (b) in the case of a body corporate, the greater of—
>
> (i) $10,000,000; or
>
> (ii) either—
>
> (A) if it can be readily ascertained and if the Court is satisfied that the contravention occurred in the course of producing a commercial gain, 3 times the value of any commercial gain resulting from the contravention; or
>
> (B) if the commercial gain cannot be readily ascertained, 10% of the turnover of the body corporate and all of its interconnected bodies corporate (if any).

[12] Section 80 of the Act was amended in 2001 to increase substantially the penalties for anti-competitive conduct.[12] Before 2001, the maximum penalty that could be imposed on a body corporate was $5 million.[13] Parliament had also stipulated a list of balancing factors that the court must take into account in determining an appropriate penalty for anti-competitive conduct.[14] Section 80(2) previously read:[15]

> In determining an appropriate penalty under this section, the Court shall have regard to all relevant matters, including—

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12 Commerce Amendment Act 2001, s 17(1) and (2). For more information about the context of the Commerce Act penalty regime, see Ben Hamlin and Matt Sumpter "Fixing the price of Commerce Act breaches" [2011] NZLJ 230 at 230–231.

13 Section 80(1) (repealed).

14 Section 80(2) (repealed).

15 Applying between 1 July 1990 and 25 May 2001.

> (a) The nature and extent of the act or omission:
>
> (b) The nature and extent of any loss or damage suffered by any person as a result of the act or omission:
>
> (c) The circumstances in which the act or omission took place:
>
> (d) Whether or not the person has previously been found by the Court in proceedings under this Part of this Act to have engaged in any similar conduct.

[13] It is accepted that the reference to "all relevant matters" in the current s 80(2A) will bring to account all those factors previously set out in s 80(2).[16] In *Commerce Commission v Qantas Airways Ltd*, the High Court affirmed the relevance of the following factors in assessing an appropriate penalty:[17]

(a) the duration of the contravening conduct;

(b) the seniority of the employees or officers involved in the contravention;

(c) the extent of any benefit derived from the contravening conduct;

(d) the degree of market power held by the defendant;

(e) the role of the defendant in the impugned conduct;

(f) the size and resources of the defendant;

(g) the degree of cooperation by the defendant with the Commission;

(h) the fact that liability is admitted; and

(i) the extent to which a defendant has developed and implemented a compliance programme.

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16 See *Commerce Commission v Qantas Airways Ltd* HC Auckland CIV-2008-404-8366, 11 May 2011 at [26]; *Commerce Commission v Alstom Holdings SA* [2009] NZCCLR 22 (HC) at [19].

17 *Qantas* at [28], citing *Commerce Commission v Geologistics International (Bermuda) Ltd* HC Auckland CIV-2010-404-5490, 22 December 2010 at [20]. See also *Commerce Commission v New Zealand Diagnostic Group Ltd* HC Auckland CIV-2008-404-4321, 19 July 2010 at [17].

The Penalty Judgment

[14] The Commission sought an order, pursuant to s 80(1) of the Act, that Telecom pay a pecuniary penalty in the range of $20 to 25 million. Telecom submitted that no penalty should be fixed, leaving the breach to be marked by declaratory orders and an order for costs. Telecom submitted that the very limited nature of the proven contravening conduct and the absence of evidence of material commercial gain or exclusionary effects told against the imposition of a pecuniary penalty.

[15] The High Court noted that it is well-established that the primary objective of determining penalties under the Act is deterrence.[18] Penalties imposed must be such as to amount to a real deterrent "and not merely some kind of acceptable licence fee".[19] The Court said that the relevant factors that provided an appropriate framework for considering the contravening conduct in this case were the nature and extent of the contraventions, the duration of the contravening conduct, the deliberateness of the conduct, knowledge of senior management, the commercial gain derived and loss or damage to others.[20]

[16] The High Court identified the maximum available penalty it could impose. It accepted that Telecom's commercial gain could not be "readily ascertained".[21] Accordingly, pursuant to s 80(2B) of the Act, the maximum penalty was the greater of either $10 million or 10 per cent of Telecom's turnover. Based on Telecom's annual report for its most recent accounting period, 10 per cent of its turnover was $279.2 million.

[17] The High Court held that the breach was not "limited and minor", as Telecom contended. The price squeeze was injurious to competitors, brought significant benefits to Telecom and was damaging to the competitive process.[22] The Court said

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18 Referring to *New Zealand Bus Ltd v Commerce Commission* [2007] NZCA 502, [2008] 3 NZLR 433 at [197]–[199], *Commerce Commission v New Zealand Bus Ltd (No 2)* (2006) 3 NZCCLR 854 (HC) at [17] and [25] and the Commerce Amendment Bill 2001 (296-2) (select committee report) at 3 and 23.

19 Penalty Judgment at [4], quoting *Commerce Commission v BP Oil New Zealand Ltd* [1992] 1 NZLR 377 (HC) at 383.

20 At [7].

21 At [46].

22 Penalty Judgment at [49].

that the breach was a result of a deliberate strategy, apparently sanctioned at the highest levels of Telecom, to price data tails at a level that would preclude price competition between Telecom and other TSPs. There was no evidence that Telecom had carried out an ECPR analysis or sought advice on the issue. The Court said it was not tenable to contend, in those circumstances, that the contravention was the result of inadvertent error.[23]

[18] The High Court noted that determining the quantum of penalty is not an exact science and that only limited assistance could be gained from previous authorities.[24] While it accepted that Telecom's conduct was sustained, deliberate and injurious, it considered it important to recognise in fixing the penalty that Telecom's pricing regime was shown for the most part to be ECPR-compliant. The violations directly affected only a small proportion of its data transmission business. Although countenanced at a high level, the breach was not flagrant or wilful. Nor did it involve covert or collusive behaviour. However, the Court considered that Telecom could not rely on "the uncharted waters of ECPR pricing".[25] No weight could be given to the complexity and uncertainty of the law. Telecom's previous experience of ECPR in the *Telecom v Clear* litigation was a further reason why it could not rely on uncertainties about the application of the law to the pricing of data tails.[26]

[19] The High Court said that the penalty should reflect the size and financial circumstances of Telecom and its position of influence and importance in the telecommunications industry. The goal of specific deterrence required that the penalty take account of the size and resources of the contravening company.[27] Thus after weighing all relevant matters, the High Court ordered that Telecom pay a pecuniary penalty in the sum of $12 million in respect of its contravention of s 36. The Court noted that this was the highest penalty imposed in New Zealand to date for a breach of the Commerce Act, but that comparisons with previous penalties did not afford any real insight into the relative seriousness of the contravention.[28]

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23 At [50].
24 At [51].
25 At [56].
26 Penalty Judgment at [58].
27 Penalty Judgment at [57].
28 At [59].

Issues on appeal

[20] On appeal, Telecom argues that the High Court erred in imposing any penalty at all. Alternatively, Telecom argues that the Court erred in imposing a penalty of $12 million.

[21] Telecom's core criticism is that the Penalty Judgment failed to provide any rational connection between the $12 million penalty imposed and the objects of general and specific deterrence, which must invariably be informed by commercial gain, or at least the size of the affected markets and thus the impact on competition in the market.

[22] In particular, Telecom submits that the High Court's description of the extent of the commercial gain as "significant" was meaningless in the absence of at least some analysis of the size of the affected market. It says that the Commission failed to satisfy its onus as plaintiff by calling evidence that would enable the Court to assess the significance of the contravention.

[23] The Commission supports the High Court judgment. It also submits that the breach in the one-tail scenario provides further justification for a severe penalty and in fact makes the present penalty appear light. It does not, however, seek an increased penalty.

[24] The more particular issues for determination identified by the parties are:

(a) Did the High Court err in holding that Telecom's pricing had significant exclusionary effects on competition and that Telecom obtained significant commercial gain from its pricing?[29]

(b) Did the High Court err in holding that Telecom's pricing was a result of a deliberate strategy sanctioned at the highest levels of Telecom?

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[29] The parties had identified this issue as two separate issues. However, the arguments made in relation to the two issues overlap and it makes sense to consider them together.

(c) Did the High Court err in failing to take due account of what Telecom contends was the novelty of the points determined in the Liability Judgment and/or Telecom's practical inability to ensure, in advance, compliance with ECPR on a circuit-by-circuit basis?

(d) Did the High Court err in failing to acknowledge the importance of proportionality in relation to other New Zealand penalties under (before and after the 2001 amendments to) s 80 of the Commerce Act, and in giving weight to two Federal Court of Australia penalty judgments?

[25] Before turning to the specific issues raised we make two general comments.

General comments

[26] The first comment we make is that Telecom's arguments have lost much of their force because this Court has held that there was a breach of s 36 of the Act across the whole of the relevant market (that is, the wholesale market outside major CBD areas for data tails):[30] both in the one-tail and the two-tail scenario.

[27] The second general comment we make is that many of Telecom's arguments rest on the premise that penalties should be related to commercial gain. We accept that commercial gain is an important consideration. In particular, as the High Court said, it is important that penalties are set at a level such that they are not regarded as a mere licence fee.[31]

[28] However, commercial gain is not the sole or even the primary consideration. The primary consideration is deterrence and penalties must be set at a level that achieves both specific and general deterrence.

[29] In a case such as this (involving exclusionary conduct), commercial gain cannot be readily ascertained. Parliament has specifically provided for such

30 See the market definition at [39(b)] of the Substantive Appeal Judgment and [35] of the Liability Judgment.

31 Penalty Judgment at [4], referred to at [15] above.

situations by allowing a penalty to be fixed by reference to the turnover of the group involved. Telecom's submission that penalties should nevertheless be tied to commercial gain, even when it cannot be readily ascertained, runs counter to this provision.

Did the High Court err in holding that Telecom's pricing had significant exclusionary effects on competition and that Telecom obtained significant commercial gain from its pricing?

Telecom's argument

[30] Telecom submits that the High Court erred in assuming that commercial gain was a necessary consequence of the exclusionary effects that the Commission had identified.[32] In particular, Telecom says the Court was wrong to conclude that the exclusionary effects resulted in the following consequences: higher retail prices; the opportunity to cross-sell other telecommunications business; and the benefits consequent on a slower roll-out of rival networks.

[31] Telecom also submits that the Court wrongly held that it was entitled to assume that Telecom's commercial gain was significant.[33] Telecom says that the Court erred in failing to attempt to quantify the allegedly "significant" gain. It also says that the Court failed to give any weight to the Commission's failure to call evidence that would enable the Court to assess the significance of the ECPR violations. Telecom submits that the assessment of penalty accordingly should have proceeded on an assumption of no, or no significant, commercial gain.

Consequences of exclusionary effects

(a) Higher retail prices

[32] Telecom says that the Court erred in holding that it could assume that a breach of ECPR would lead to higher retail prices. Telecom submits that, in the two-

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[32] The exclusionary effects identified by the Commission are set out in the Penalty Judgment at [28].

[33] Penalty Judgment at [49].

tail scenario, the available evidence suggested strongly that no retail price reductions could have been expected even if two-tail circuits had been priced in accordance with ECPR. This is because the supply of data tails priced at ECPR for use in the two-tail scenario would not increase price competition, due to the network inefficiency created in that scenario.[34] It also submits that the market for retail HSDT services was at all times subject to competitive forces because of Telecom's supply of data tails at ECPR-compliant prices for resale.

[33] Telecom further submits that Telecom's "Streamline" pricing (Telecom's retail price book over the relevant period) did not contain any element of monopoly profit. It points to the fact that there was no evidence of any difference in Telecom's pricing between competitive and non-competitive areas, or between customers that could be serviced by a TSP self-provisioning at least one tail and those that could not. It says that this suggests that the retail prices charged by Telecom were not higher than a competitive level.

[34] Telecom's argument that the two-tail scenario was inherently inefficient was dismissed by this Court in the Substantive Appeal Judgment,[35] and must similarly be rejected here. As this Court noted,[36] Telecom's argument ignores a TSP's ability to compete with Telecom by differentiating its service on the backbone and by creating efficiencies through the provision of retail support.

[35] Telecom's argument that competition from resale was a sufficient alternative competitive restraint, was, in our view, correctly dismissed by the High Court in the Penalty Judgment.[37] As the High Court noted, the evidence given at trial was that TSPs did not regard resale as a desirable or effective option, because it did not enable differentiation from Telecom's service, or efficiency gains from innovation.[38]

[36] We also agree with the High Court's rejection of Telecom's argument that its Streamline pricing indicated that the retail prices charged by Telecom were no higher

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34 This mirrors an argument that Telecom raised in its appeal against the Liability Judgment, recorded at [198]–[201] of the Substantive Appeal Judgment.
35 Substantive Appeal Judgment at [202]–[204].
36 Substantive Appeal Judgment at [203].
37 Penalty Judgment at [33]–[34].
38 Ibid.

than a competitive level.[39] The Court said that "[n]othing can be taken from the fact that Streamline prices stood unchanged for over four years. It is equally arguable that this indicated a lack of price competition".[40] Further, as this Court held in the Substantive Appeal Judgment,[41] observation of Telecom's behaviour in the major CBD areas did not assist in answering the question of what a non-dominant firm in a "competitive" market would do, as Telecom had not been genuinely denied all aspects of its dominance in the major CBD areas.

[37] As the Commission submits, orthodox economic theory predicts that the presence of competition in a market will drive down retail prices so that any excess profits or cost inefficiencies will be eliminated over time. Telecom has not pointed to anything to suggest orthodox economic theory has no application in this case. The price squeeze had an effect both on price competition and upon competitive dynamics in the market, with a corresponding reduction in efficiency incentives.

(b) Cross-selling of other products

[38] Telecom also says that the High Court erred in accepting that Telecom gained the opportunity of cross-selling other telecommunications business to customers, as a TSP that was unable to offer a data tail would have been prejudiced in its ability to compete for the supply of other telecommunications services. First, Telecom says that this finding relates to impact in a market that was not pleaded by the Commission and thus cannot be correct. Secondly, Telecom says that this finding is contrary to the High Court's conclusion in the Liability Judgment that, where the customer relationship in relation to bundled services was lost as the result of Telecom's supply of a data tail, this did not have to be reflected in Telecom's opportunity costs and thus the calculation of the ECPR price.[42] If the bundle of services could not form part of the assessment of ECPR, it should not form part of the basis of gains.

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39 Penalty Judgment at [35]–[36].
40 At [36].
41 Substantive Appeal Judgment at [153].
42 Liability Judgment at [70]–[71].

[39] We accept the Commission's submissions on this point. In relation to Telecom's pleadings argument, the Commission says that it was not asserting that a bundled market was impacted by the conduct; rather it was pleading that exclusion occurred in the data market and these potential rivals posed a threat to other revenue sources, such as voice services. The Commission also says that the High Court's finding that bundling could not be taken into account in the calculation of ECPR prices for data tails is not inconsistent with the proposition that the breach interfered with the ability of TSPs to enter into business relationships. The damage inflicted on TSPs and consumers by Telecom's breach of s 36 extends beyond the data market because it interfered with the ability of TSPs to enter into business relationships with customers where the TSP did not have its own data tails. Denying the TSP this first sale opportunity prevented (or at the very least made it more difficult to make) additional sales and the cross-selling of other telecommunications services.

(c) Slower roll-out of other networks

[40] Telecom says that the High Court was correct to accept that "slower roll-out of rival networks" did not logically flow from the exclusionary conduct identified.[43] However, Telecom says that the High Court erred in finding that "in areas where there was a lower level of demand, it may be surmised that the price squeeze would cause TSPs to retract their level of operation".[44] Telecom says that there was no evidence led by the Commission to support this conclusion. Nor did the Court explain how the demand level impacted upon the connection between Telecom's pricing and network roll-out. Nor was any attempt made to define areas of "lower level of demand" in which this effect might be observed, or to quantify its impact on Telecom's revenue.

[41] This point can be dealt with by reiterating that this Court upheld the Commission's cross-appeal against the Liability Judgment and concluded that Telecom's pricing had breached s 36 in the one-tail scenario. There was therefore a universal breach in the wholesale market outside major CBD areas for data tails. Thus, the economic case for roll-outs of rival networks was limited. TSPs would

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43 Penalty Judgment at [40].
44 Ibid.

encounter real difficulties because, if they built their own tails, they faced high fixed costs and would face the one-tail pricing under which they would have had to pay for their investment twice.

Failure to assess extent of commercial gain

[42] Telecom submits that the Court erred in failing to address the quantum of the purported benefits to Telecom, beyond characterising them as "significant", and thus failed to provide a rational connection between achieving the objects of general and specific deterrence and the penalty to be imposed on Telecom. Telecom says that the assessment of the penalty must invariably be informed by commercial gain, or at least by the size of the affected markets and thus the potential economic impact of the breach. It says that the Court failed to give any weight to the Commission's failure to call such evidence.

[43] The flaw in Telecom's argument is that this case deals with exclusionary behaviour. The exclusionary effects of the price squeeze were inherently unquantifiable. The key issue was not how many data tails were in fact leased to TSPs, but rather the number that were not leased because of the price squeeze.[45] The High Court made its finding of exclusionary effects based on the kind of consequences that economic theory would predict when wholesale prices exceed ECPR. We accept the Commission's submission that there was no need for either the Commission or the Court to quantify the extent of consumer harm by reference to direct evidence.

Did the High Court err in holding that Telecom's breach of s 36 was a result of a deliberate strategy sanctioned at the highest levels of Telecom?

[44] Telecom submits that the High Court erred in holding that Telecom's breach of s 36 was "the result of a deliberate strategy, apparently sanctioned at the highest levels of Telecom, to price data tails at a level that would preclude price competition between Telecom and other TSPs".[46] Telecom repeats a number of its arguments that

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[45] See the Substantive Appeal Judgment at [189].
[46] Penalty Judgment at [50].

it raised in support of its appeal against the Liability Judgment.[47] For example, Telecom says that the evidence demonstrated that it had a pro-competitive purpose at all times and that there was no relevant delay between the introduction of its Streamline pricing and Carrier Data Pricing (CDP).[48] This Court dismissed those arguments in its Substantive Appeal Judgment[49] and they must be similarly rejected here.

[45] The only new argument that Telecom raises in relation to this issue is its submission that the High Court erred in describing Telecom's strategy as having been "understood and approved at the highest levels of management".[50] It says that the Court based this conclusion on its erroneous view that Ms Theresa Gattung, who approved CDP, was Telecom's Chief Executive Officer (CEO) at the time that CDP was introduced.[51] Ms Gattung was instead the Group General Manager of Telecom's Services business unit at the time.

[46] Although the High Court erred in describing Ms Gattung as the CEO of Telecom at the time CDP was introduced, this is no more than an inconsequential slip. The High Court was still correct in describing Telecom's strategy as having been authorised at the highest levels of Telecom's management. The instigation and continuation of the price squeeze was sanctioned by very senior personnel within Telecom. Further, as the Commission points out, Ms Gattung became the CEO in October 1999, only a few months after CDP was approved. After she became the CEO, the price squeeze continued, in breach of s 36, until 2004.[52]

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47 These are recorded at [257]–[258] of the Substantive Appeal Judgment.

48 Carrier Data Pricing (CDP) was Telecom's wholesale pricing over the majority of the relevant period. The Commission's case was that wholesale prices under CDP were so high relative to the retail prices under Streamline that it caused a price squeeze.

49 At [268]–[277] of the Substantive Appeal Judgment.

50 Penalty Judgment at [22].

51 Referring to the Penalty Judgment at [22].

52 Although the actionable conduct extended from 18 March 2001 until September 2004, when, because of the threat of regulation, Telecom introduced an Unbundled Partial Circuit service to TSPs at cost-based pricing, the actual conduct in breach of s 36 extended from 1999, when Streamline was introduced.

Did the High Court err in failing to take due account of the novelty of the points determined in the Liability Judgment and/or Telecom's practical inability to ensure, in advance, compliance with ECPR?

Telecom's argument

[47] Telecom submits that the High Court erred in finding that no weight could be given to "the complexity and uncertainty of the law"[53] in determining the penalty in the present case. Telecom says that the Liability Judgment made novel findings regarding the application of s 36 and ECPR. Telecom also says that the High Court should have taken into account Telecom's practical inability to ensure, in advance, compliance with ECPR.

[48] Telecom says that by failing to have due regard to these factors, the Court failed to take account of the risk of over-deterrence by imposing too high a penalty. It says that the risk of over-deterrence is heightened where there is uncertainty in the definition of the prohibited conduct, referring to comments made by this Court in *New Zealand Bus Ltd v Commerce Commission*.[54]

[49] Telecom also says that the Court erred in concluding that the goal of specific deterrence "requires that the penalty take account of the size and resources of the contravening company".[55]

Our assessment

[50] Telecom's submissions regarding the allegedly novel findings of the High Court and Telecom's practical inability to ensure compliance with ECPR merely repeat arguments that it raised in support of its appeal against the Liability Judgment. This Court dismissed those arguments in its Substantive Appeal Judgment. For the reasons set out in that judgment,[56] this is not a case where there were "uncertainties" about the application of the law to the pricing of data tails. The risk of over-

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53 Penalty Judgment at [56].
54 *New Zealand Bus Ltd v Commerce Commission*, above n 18, at [195].
55 At [57], citing *Carter Holt Harvey Building Products Group Ltd v Commerce Commission* (2001) 10 TCLR 247 (CA) at [94].
56 At [80]–[91], [93]–[103] and [171] of the Substantive Appeal Judgment.

deterrence was therefore not acute.

[51] We also accept the Commission's submission that the fact that Telecom itself put ECPR before the Privy Council in *Telecom v Clear* as the appropriate economic model for pricing an essential input is an additional reason why it cannot rely on the "uncertainties" about the application of the law to the pricing of data tails.[57] Further, Telecom made no attempt to apply ECPR to its pricing of data tails.

[52] We accept the Commission's submission that the High Court was conscious that it should not over-penalise Telecom. It took account of the fact that non-compliant sales were a small proportion of Telecom's data transmission business and that its pricing regime was largely ECPR-compliant.[58] It accepted that Telecom may have genuinely held the belief that it was not in breach of the Commerce Act,[59] and it accepted that the breach was not flagrant or wilful and did not involve covert or collusive behaviour.[60] Now that the one-tail scenario has been held by this Court to have also been in breach of s 36, the risk of over-deterrence has diminished even further.

[53] In addition, we accept the Commission's submission that the High Court properly recognised that, by increasing the available penalties in 2001 (through the enactment of the Commerce Amendment Act 2001), Parliament had sought to send a "much stronger signal than the current provisions that the deterrence objective will only be served if anti-competitive behaviour is profitless".[61] The Commission says that the Court was thus aware of its obligation to reflect that "much stronger signal" in its judgment.

[54] The only new argument that Telecom raises in relation to this issue is its submission that the High Court erred in concluding that the goal of specific deterrence requires that the penalty take into account the size and resources of the contravening firm. We consider that the High Court was correct to hold that the

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57 This is also recognised in the Penalty Judgment at [58].
58 Penalty Judgment at [56].
59 At [50].
60 At [56].
61 Commerce Amendment Bill 2001 (296-2) (select committee report) at 23, quoted in the Penalty Judgment at [3].

penalty "should reflect the size and financial circumstances of Telecom and its position of influence and importance in the telecommunications industry".[62]

[55] This Court has recognised that the size and resources of a firm, and its position of influence in the industry, are relevant to deterrence. For example, in *Carter Holt*, this Court said:[63]

> It is commonly accepted that it requires higher monetary penalties to constitute deterrence to affluent parties than to "indigent" ones.

[56] We accept that caution is required in placing weight on the total size of the firm in determining an appropriate penalty, but, as the Commission points out, this would only have been a problem if the High Court had treated the maximum penalty in s 80(2B) as a proxy for Telecom's commercial gain. The High Court did not treat the maximum penalty ($279.2 million) as a proxy for Telecom's commercial gain. This is clear from the fact that the penalty imposed only amounted to 4.3 per cent of the maximum penalty available.

Did the High Court err in failing to acknowledge the importance of proportionality in relation to other penalties imposed under s 80, and in giving weight to two Australian penalty judgments?

The High Court judgment

[57] The High Court said that only limited assistance in determining the assessment of penalty was to be gained from previous authorities. This was because the determination of the quantum of penalty was not an exact science, particularly in the present case, where there was no quantification of the commercial gain.[64]

[58] The Court said that many of the New Zealand and Australian cases to which it was referred related to contraventions that preceded the significant increases in maximum penalties of the last ten years (in New Zealand, by the Commerce

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[62] At [57]. The Court noted, in fn 40 of the Penalty Judgment, that this was regarded as a "very significant factor" in *Australian Competition and Consumer Commission v Telstra Corp Ltd* [2010] FCA 790 at [210].

[63] *Carter Holt*, above n 55, at [94]. See also *Qantas*, above n 16, at [28] and *New Zealand Diagnostic Group*, above n 17, at [17].

[64] Penalty Judgment at [51].

Amendment Act 2001, and in Australia, by amendments to s 76 of the Trade Practices Act 1974 (Cth)[65]). Most involved the approval of agreed penalties. None of them involved contraventions arising in closely comparable circumstances.[66]

[59] The High Court considered that *Australian Competition and Consumer Commission v Telstra Corp Ltd* (*Telstra*)[67] was the closest case on its facts to the present case, because it involved the denial of access to interconnection by a dominant telecommunications provider. Penalties totalling AUD18.55 million were imposed, after deducting 30 per cent for mitigating factors. Telstra admitted that over a period of two years it denied access-seekers interconnection to exchange facilities in various locations. It also admitted to engaging in misleading or deceptive conduct. The High Court said that the commercial gain to Telstra appeared to have been unquantifiable, as the subject was not discussed. Similarly, there was insufficient evidence to permit the Federal Court of Australia to conclude that loss or damage was sustained by access seekers; the Federal Court relied on the prima facie case that contraventions did lead to some harm to consumers and end users.

[60] The High Court also considered that *Australian Competition and Consumer Commission v Cabcharge Australia Ltd* (*Cabcharge*),[68] where penalties totalling AUD14 million were imposed for contraventions of the equivalent of s 36, was in a broadly similar category to the present case. Relevant considerations that the Federal Court took into account were the period of time over which the contraventions occurred (three years); the fact that Cabcharge is a prosperous publicly listed company with substantial market power; the fact that the conduct was deliberate, although Cabcharge was not conscious that it was in breach of the Act; and that its most senior employees and management participated in the contravening conduct. In mitigation, the Federal Court referred to the absence of previous contraventions and the discount for cooperating with the Australian Competition and

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65 Section 76 of the Trade Practices Act 1974 (Cth) was amended by the Trade Practices Legislation Amendment Act (No 1) 2006 (Cth), sch 9, cl 4. The Trade Practices Act 1974 (Cth) has now been replaced by the Competition and Consumer Act 2010 (Cth).

66 Penalty Judgment at [51].

67 *Telstra*, above n 62.

68 *Australian Competition and Consumer Commission v Cabcharge Australia Ltd* [2010] FCA 1261.

Consumer Commission (ACCC). It also worked in Cabcharge's favour that no parties had exited the market as a result of the predatory pricing.[69]

Telecom's argument

[61] Telecom submits that the High Court erred by failing to acknowledge the importance of proportionality in determining the quantum of penalty. In particular, it argues that the High Court placed undue reliance on the two Federal Court of Australia decisions and failed to have regard to New Zealand comparators (both before and after the 2001 amendments to the Commerce Act). As a result, Telecom says that the $12 million penalty imposed was disproportionate.

Our assessment

[62] Assessments of penalty in analogous cases may provide guidance to the court to ensure that there is parity of treatment in similar circumstances.[70] However, while pecuniary penalties imposed in one case may provide a guide, that guide will seldom be able to be used mechanically. Changes in circumstance will affect the appropriate penalty in a case, such as differing circumstances of the conduct, size, market power and responsibility for the contraventions. These factors, among others (including mitigating factors), complicate any attempt to compare penalties imposed in one case with those imposed in another.[71]

(a) Australian cases

[63] Telecom says that the High Court erred in relying on *Telstra* and *Cabcharge* as relevant comparators, without having regard to differences in calculation, statutory context, and market size. Telecom says that both cases involved very different products and markets to the present. In such circumstances, neither case could be safely relied upon as a relevant comparator in this case.

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[69] *Cabcharge* at [58].

[70] See the discussion in *Telstra*, above n 62, at [211] and Matt Sumpter *New Zealand Competition Law and Policy* (CCH, Auckland, 2010) at [1705].

[71] See *Telstra* at [211]–[212], *Commerce Commission v Giltrap City Ltd* (2002) 10 TCLR 305 (HC) at [12] and *Commerce Commission v Caltex New Zealand Ltd* (2000) 9 TCLR 366 (HC) at [32].

[64] Telecom says that, by relying on *Telstra*, the High Court erred in two fundamental respects. First, s 570 of the Telecommunications Act 1997 (Cth) (dealing with pecuniary penalties for breaches of the Act) does not explicitly include "commercial gain" as a factor in assessing an appropriate penalty, thus explaining its absence from the judgment. By comparison, s 80(2A)(b) of the Commerce Act makes it a mandatory relevant consideration. Secondly, the prima facie suggestion relied upon by the Federal Court was that contraventions of the Telecommunications Act (and Trade Practices Act) led to harm to consumers and end users. The inference was that the refusal of statutory interconnection requirements that have a statutory purpose of enhancing competition will harm consumers and end users. Telecom says that that inference is of a different nature to the assumption of supra-competitive retail pricing made by the High Court, which lacks any similar basis in the statutory purpose. Further, even in those circumstances, the Federal Court held that the "inability of the ACCC to quantify the damage is a consideration to be given some weight".[72] Telecom says that, in contrast, no apparent weight was given to this matter by the High Court, nor to the associated risk of error and over-deterrence.

[65] However, as the Commission points out:

(a) the High Court's extensive consideration of matters relating to commercial gain shows that the Court was well aware that commercial gain was a mandatory consideration under s 80;

(b) there is no suggestion that the Federal Court in *Telstra* considered harm to result merely as a matter of inference from statutory purpose; and

(c) contrary to Telecom's submission, the High Court gave weight to the inability to assess commercial gains from the wholesale revenue generated by non-compliant sales, by expressly assuming in Telecom's favour that there were no or no significant commercial gains.[73]

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[72] *Telstra* at [187].
[73] Penalty Judgment at [27].

[66] Telecom criticises the High Court's reference to *Cabcharge* because it says that, unlike in the present case, penalties were set in *Cabcharge* by reference to the turnover of the defendant, which was effectively a single product firm in the affected markets, and there was evidence of the size of the market. However, we accept the Commission's submission that this criticism misinterprets the extent to which the Court was comparing *Cabcharge* to the present case. Although describing *Cabcharge* as "in a broadly similar category", the Court pointed out the differences between it and the present case: the fact that it involved an agreed penalty and a discount for cooperating with the ACCC, and that the defendant, although large, was not as large as Telecom. While any comparison was acknowledged to be of "limited assistance", the High Court also acknowledged that there were some significant similarities between the two cases, including serious contraventions over a long period, deliberate but not wilful conduct, and the fact that senior employees and management were involved.

[67] In summary, while caution in referring to Australian authority is required,[74] Telecom has overstated the weight that the High Court accorded the Australian cases. The Court acknowledged that these two cases fell within a broadly comparable category to the present case, but did not rely on the penalties in those cases without having regard to their distinguishing features. It was open to the Court to consider relevant Australian precedents given the similarity between the wording of s 80 of the Commerce Act and s 76 of the Trade Practices Act (now s 76 of the Competition and Consumer Act 2010 (Cth)).

(b) New Zealand cases

[68] Telecom says that the High Court failed to have regard to the level of penalties imposed in New Zealand for breaches of s 36 of the Commerce Act, including those preceding the Commerce Amendment Act 2001, which remained relevant given that the conduct penalised commenced prior to the amendment.[75] Telecom notes that this penalty exceeded the next highest penalty imposed then to date, in respect of covert cartel activity conducted over a four year period, by over $9

74 *Commerce Commission v Herberts Bakery Ltd* [1991] 2 NZLR 726 (HC) at 729.

75 Telecom's contravening conduct over the period 18 March 2001 to 25 May 2001 occurred before the amendment came into force.

million.[76]

[69] The Commission submits that Telecom is incorrect in its contention that the Court did not have regard to New Zealand cases. It says that full reference to such cases was made by both parties in their submissions, and the Court expressly acknowledged that the previous authorities were of limited assistance, as none involved contraventions arising in closely comparable circumstances.[77] It also acknowledged the fact that its decision imposed the highest penalty in New Zealand to date for a breach of the Commerce Act.[78]

[70] The fact that the $12 million penalty imposed by the High Court is the highest penalty imposed in New Zealand to date is not, of itself, an indication that the penalty is excessive. While penalties in other cases may provide a useful guide, an appropriate penalty is one that is proportionate to the particular anti-competitive conduct.

[71] Penalty decisions that preceded the Commerce Amendment Act 2001 remain relevant as comparator cases. However, as the High Court acknowledged,[79] those cases will be of limited assistance in determining the level of penalties that a court is likely to impose in future cases, given the increased pecuniary penalties now available under s 80(2B).

Conclusion

[72] We have, in the Substantive Appeal Judgment, found breaches of s 36 both in the two-tail and one-tail scenario. We therefore do not need to consider if the penalty imposed by the High Court was appropriate if there had merely been a breach in the two-tail scenario. We do, however, consider that the penalty is by no means excessive given the extent of the breach we are now dealing with. We accept the Commission's submission that the factors relevant to the penalty decision included:

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[76] Telecom referred to *Commerce Commission v Koppers Arch Wood Protection (NZ) Ltd* (2006) 11 TCLR 581 (HC).

[77] Penalty Judgment at [51].

[78] At [59].

[79] At [59].

(a) The need to set the penalty at a realistic level to deter Telecom from engaging in similar conduct in the future, and also to achieve general deterrence by sending a strong signal to the business community that such conduct by dominant firms will result in heavy penalties.

(b) The extent of Telecom's breach, which was a universal violation of s 36 in the wholesale market outside major CBD areas for data tails, in both the two-tail and one-tail scenarios.

(c) The severity of the contravention, by which Telecom intended to prevent/deter TSPs from competing in the relevant retail and wholesale markets, and which constituted a constructive refusal to supply an essential input. We also note that, in most instances, the wholesale price of two data tails exceeded Telecom's end-to-end retail price.

(d) The lengthy period of actionable conduct, which lasted for over three and a half years.[80]

(e) The deliberateness of the conduct. This was a strategy pursued by very senior Telecom personnel, to treat its competitors as mere resellers of its product rather than full competitors in their own right.

(f) The nature and extent of Telecom's commercial gain, particularly given the exclusionary effect of the conduct, which had the effect of maintaining Telecom's market dominance.

(g) Telecom's size and its significant influence in the telecommunications industry.

(h) The lack of mitigating features that would warrant a discount from the penalty.

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80 Remembering that the actual conduct in breach of s 36 extended from 1999, when Streamline was introduced. See fn 52 above.

Result and costs

[73] The appeal is dismissed.

[74] In the Substantive Appeal Judgment, the appellants were ordered to pay the respondent costs for a complex appeal on a band B basis plus usual disbursements. We certified for three counsel. As the present appeal was effectively prepared and heard together with the hearing of that appeal (which took place over six days in total), we consider that a reduced costs order should be made.

[75] We therefore order the appellants to pay the respondent costs for a complex appeal, but limited to a day's hearing and two days' preparation plus usual disbursements. We certify for two counsel.

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